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ABSTRACT

This book is designed to help leaders of higher education institutions set and negotiate compensation for academic presidents. Its central aim is to strengthen governing board decisions regarding presidential compensation, though it also focuses on other highly compensated institutional officers. The findings are based on interviews with independent and public higher education officials, legal experts, government officials, and recruitment and compensation specialists, as well as a survey of board chairs and presidents from four- and two-year public and private institutions. The study finds that the roles of college and university presidents differ from their counterparts in several respects: their responsibilities far exceed their authority, which is limited by statute, bylaws, or institutional culture; their motivation for attracting funding is to enrich the institution's mission rather than build value for shareholders; and much of their prior work as teachers and scholars does not truly prepare them for the responsibilities of the presidency. Chapters summarize major findings and 'good practice' recommendations. They also discuss the context for presidential compensation; public accountability demands; board structure and decision making; public communication strategies; using outside information and expertise; and employment contracts. Two appendixes offer additional options to consider in compensation contracts and a summary of survey results. (SM)

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# Presidential Compensation in Higher Education

## Policies & Best Practices

BY ROBERT H. ATWELL
AND JANE V. WELLMAN

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# Foreword

In the end, say economists, it *is* about money, not just about "principle." What we earn—and the process by which we are paid—matters. It matters to the long-term viability of organizations that they are able to attract and retain the most capable and talented leaders in their profession. And it matters to those who hold top leadership positions that they feel appreciated and that their exemplary work is rewarded financially and in other ways.

Individuals who are drawn to the academic presidency are deeply committed to the profession and to the purposes of higher education. Despite the changes in the marketplace, the position of college president continues to be a calling as much as a way to make a living. College presidents deserve to be appropriately compensated for their work, and they need to be well informed about the options they have in their compensation packages. Yet most presidents and boards do not take the time to gain expertise about ways to approach presidential compensation.

This timely book aims to help leaders of our higher education institutions set and negotiate compensation for academic presidents. Final responsibility for this vexing task has always started and stopped with the governing board, but there is much less room for bad judgment than was true even five years

ago. At the same time, there is lots of room for boards and their leaders to exercise courage to fulfill their fiduciary and leadership responsibilities in the service of their institutions.

One of the recommendations of the national Commission on the Academic Presidency in its 1996 report was that AGB study the complex issues bearing on presidential compensation. More than one year ago, we invited Robert H. Atwell and Jane V. Wellman to undertake this effort. Their good work has resulted in this compendium of perspectives and advice for boards of trustees, presidents, and others concerned with effective academic presidencies.

Although the central aim of this book is to strengthen governing board decisions concerning presidential compensation, its principles also will be relevant to other highly compensated institutional officers. Further, its simultaneous publication with the AGB book *Presidential and Board Assessment* provides a comprehensive picture of how performance and compensation reviews should (and should not) relate to one another. Both books enable boards and presidents to consider options that comport with their institution's traditions and values for adoption in institutional policy.

*This book is not intended to substitute for appropriate legal and tax advice on the complex matters it addresses.* Although every effort has been made to provide accurate information, applicable laws and regulations change rapidly and often are open to different interpretations. As a result, boards must make compensation decisions based only on complete and accurate advice and information.

In addition to conducting scores of interviews with independent and public higher education officials, legal experts, government officials, and recruitment and compensation specialists, the authors benefited from a national survey of board chairs and presidents of two-year and four-year institutions and from the guidance of many knowledgable individuals. The

AGB Board of Directors and its Council of Board Chairs and Council of Presidents also gave helpful advice in the course of the study.

**Acknowledgments**

In addition to extending the association's gratitude to Bob Atwell and Jane Wellman, I join with them to thank many others who had a strong hand in this book's publication. We especially thank AGB Board Chair A. Marshall Acuff, Jr., the former rector of the College of William and Mary and current trustee of Sweet Briar College; Thomas E. Corts, president of Samford University and vice chair of the AGB Council of Presidents; Raymond D. Cotton, an attorney and executive compensation specialist with Mintz, Levin, Cohn, Ferris, Glovsky & Popeo; Matthew Hamill, vice president for public policy of Independent Sector; Ira W. Krinsky, managing director of the higher education practice (West) of Korn/Ferry International; Frank Mertz, president emeritus of Fairleigh Dickinson University; James E. Morley, president of the National Association of College and University Business Officers; Curtis J. Tompkins, president of Michigan Technological University; Robert E. Tranquada, board chair of Pomona College; and E.B. Wilson, board chair of St. Lawrence University.

We also thank Thomas C. Longin, AGB vice president for programs and research, who coordinated this project and the national survey, and Daniel J. Levin, AGB vice president for publications, for editing the manuscript and overseeing publication of this important work.

Grants from the Robert W. Woodruff Foundation and the William and Flora Hewlett Foundation made this book possible. AGB deeply appreciates their support on this and other important projects in trustee education and board development.

As always, we welcome reader comments and suggestions and remind you that AGB has a variety of other publications,

services, programs, and other consultative resources related to this book's subject matter.

Tom Ingram
President, Association of Governing Boards
of Universities and Colleges
Washington, D.C
March 2000

# Introduction

Governing boards take seriously their responsibilities to recruit, set compensation for, and review the performance of presidents and chancellors. For the most part, boards have established good procedures to guide them, but because the marketplace for leadership in higher education is rapidly changing, they may need to review and revise policies and practices that have worked in the past.

Changing tax laws and demands for public disclosure and accountability affect the options available to boards as they consider salaries and benefits for highly compensated employees. And new reporting requirements and Internal Revenue Service rules require boards to be able to publicly document the basis for compensation decisions. What's more, individuals from increasingly diverse backgrounds are being recruited to lead colleges and universities. They come not only from within the academy but from the corporate, governmental, and nonprofit worlds. Many of these individuals expect compensation packages that are uncommon among higher education institutions—multiyear contracts, performance bonuses, and deferred-compensation arrangements.

More women are being asked to lead institutions, as are men who are married to women with full-time careers outside

of the home. The old "two for the price of one" model, while unfortunately still present, is expanding to accommodate new leadership and changing expectations from individuals who expect to be appropriately compensated or supported for the work they do on behalf of the presidency.

All of these factors suggest that the old ways of approaching presidential compensation may need to be reviewed and refreshed to ensure that the best people continue to be drawn into the academic presidency.

*Presidential Compensation* suggests policies and practices that governing boards of public and private colleges and universities can use to set and review presidential compensation. Its aim is to improve board decisions concerning the chief executive's compensation; it is not intended to cover other institutional administrators or other highly compensated employees.

In addition to salary and benefits, the components of college and university presidential compensation usually include housing, consideration of spousal compensation, entertainment and travel expectations, and limitations on outside activities and employment. This book identifies most of these components. Governing boards should study prevailing practices in higher education—especially within comparable institutions—and then determine which of these components apply to their institution. The book discusses the decision-making process and the content of compensation arrangements, including setting and adjusting salaries, options for benefits and perquisites, severance arrangements, and performance assessment. It describes some public-policy pressures on presidential compensation that affect board structure, decision making, and performance review as well as public communication strategies. It also addresses special issues such as the role of outside experts and public college foundations.

# Summary of Major Findings

Unlike the many other areas of higher education that seem to be in a perennial state of crisis, the picture of presidential compensation that emerges from this project is of an activity that the academy has "under control." A large majority of institutions have prudent procedures in place to ensure good compensation decisions: Almost all set salaries based on a survey of their peer institutions, and almost all require periodic performance evaluations to adjust compensation packages. The internal board procedures for salary and performance reviews are well established and generally understood.

In the survey conducted for this project (see Appendix II), most presidents and board chairs reported that the ways their institutions set and review compensation work "reasonably well" and that presidents are adequately paid, though some may be undercompensated. Although many perceive that "political" and "public opinion" issues affect the process, most say they do not believe they have serious financial or other constraints that keep them from setting appropriate salaries. Few institutions report using outside counsel or consultants to help with the process. In fact, almost all use in-house expertise (staff or board members) to set compensation and review performance. Most institutions supplement in-house expertise with national data about salaries and benefits, and the large

majority say they are confident that they understand the market and the relevant legal requirements.

On the other hand, closer inspection of the survey returns and interviews with experts suggest that presidents and board chairs may think they know more than they actually do about executive compensation. For instance, only a small number say they really understand the new federal tax requirements affecting presidential compensation. Although many board members are familiar with these issues from their experience in the for-profit environment, they do not realize that the public and nonprofit sectors impose many more restrictions. As a result, some boards have developed compensation practices that unwittingly expose the president and the institution to possible tax liabilities.

Staff members who help with the survey and review process also may not be aware of changes in the tax law or of options or constraints with which they must contend. Consequently, boards that entrust this responsibility to such individuals risk adopting unimaginative compensation packages or policies that could lead to Internal Revenue Service tax penalties. Yet many boards that would like to have professional advice do not know where to go to obtain the expertise they need. While professional tax specialists and consultants generally are sophisticated, the quality of counsel from independent consultants unfortunately is not uniformly good. Presidents and board members report that when they ask for advice they often feel "hustled" by companies trying to sell them a particular financial package, which might not be the best for their particular circumstances. Others tell stories of receiving conflicting advice about tax consequences on such matters as deferred compensation from different attorneys in the same firm.

The national survey information that most institutions continue to use typically consists only of the "plain vanilla" parts of the compensation packages—salaries and standard benefit packages. Because the comparison information lacks crucial

details, its use probably perpetuates conservative compensation arrangements. As a result, most institutions report fairly conventional executive compensation packages. Unfortunately, these packages may fail to provide some options that offer the best long-term advantages not only to presidents but also to institutions.

# Summary of "Good Practice" Recommendations

*1. Boards should establish written procedures that ensure clear lines of authority and communication.* To protect privacy and encourage candid discussion, many boards delegate decisions about presidential compensation and performance review to a subcommittee or even to a single board member. Often, they make no provisions for communicating to the full board either the reasons or results of the decision-making process. While it is perfectly appropriate to delegate the review to a subcommittee—to a specially constituted compensation committee or to the executive committee, for example—reviews generally should not rest with a single member of the board. If the board delegates compensation decisions to a subcommittee, it must do so clearly and in writing. In addition, the board should review the composition of the subcommittee to ensure that the best expertise and institutional memory are represented on this panel and that no conflicts of interest exist. The board should establish appropriate channels of communication about compensation decisions, especially regarding the basis on which compensation is set.

*2. Boards should be prepared to disclose, explain, and defend in public the president's compensation package and their own decision-making process.* Neither boards nor presidents should approach the issue of public communication about presiden-

tial compensation as if there were something unseemly about it. Given the increasing availability of presidential compensation data from publicly accessible records, the board should err on the side of full and open disclosure of presidential compensation. If compensation in a public institution is supplemented through private foundation funds, this should be disclosed as well. The board should not ask the president to explain and defend publicly the presidential compensation decision-making process and outcome.

*3. The quality of information boards use to compare presidential compensation packages is inadequate.* Many institutions rely on national data to develop compensation packages. National data underreport compensation because many institutions fail to respond to surveys, and those that do participate do not always report deferred compensation or bonus arrangements. In addition, new IRS regulations require private institutions (or public institutions that supplement compensation through private foundations) to demonstrate that compensation is consistent with the market of comparable institutions. National data do not yield information suitable for comparing compensation packages among peer institutions. To ensure that a compensation package is truly appropriate for the market, boards must review the compensation practices of comparable institutions and show that its decisions reflect such a review and are based on presidential performance.

*4. Boards must be certain they receive sophisticated advice concerning compensation agreements.* The large majority of institutions rely on either in-house staff or individual board members to prepare compensation agreements. Boards are wise to invest in outside professional counsel for at least parts of the process, particularly at the time of the initial contract. This recommendation recognizes both the nature of the reporting relationship between the president and in-house staff and the rapidly changing and highly technical state of tax laws governing public and nonprofit compensation and retirement. For instance, a common mistake is to pattern deferred-

compensation packages on those available in the for-profit sector; often, such options do not exist in the nonprofit sector. Consequently, the president—and individual board members—can be exposed to tax penalties.

5. *Many institutions still operate without an employment agreement between the president and the governing board, though an increasing number of institutions now rely on formal agreements.* Although contracts are not absolutely essential, they provide a degree of clarity about the circumstances of employment that can be very important to presidents, their families, and the institution. The most important employment agreement is the first one. Ideally, this is negotiated when the president is hired. If the course of the search process makes this impractical, boards and presidents should commit to returning to a good-faith discussion of a comprehensive employment agreement within the first few months of employment. A "minimum" employment agreement should define the length of the appointment, the base salary, the benefits package, deferred compensation, performance review, salary adjustments, termination procedures, and the process to renew the agreement. A host of other provisions may be included in the contract, and the president and board should discuss and understand them. These may include such matters as spousal compensation, travel, entertainment, faculty appointments, housing, board service, and outside activities.

6. *The board must be able to document that adjustments to the initial compensation agreement are based on performance reviews and appropriate comparison of compensation data.* Performance reviews should be rooted in presidential self-assessment and annual reviews. These should be supplemented with comprehensive reviews every several years. Although performance assessments inform compensation levels, both performance assessment and compensation are intended to meet to other non-overlapping objectives. AGB has published a companion to this volume, *Presidential and Board Assessment*, which should prove useful in this regard.

# The Context for Presidential Compensation

Higher education institutions face an array of social, political, demographic, and financial challenges at the beginning of the new century. These challenges affect almost every aspect of the academic presidency, especially the intellectual and personal skills required for the job. For boards wrestling with executive compensation decisions, four factors are especially likely to affect deliberations: (1) the relatively rapid rate of presidential turnover, (2) the increasing pressure for financial-management strategies that emulate the for-profit sector, (3) the shift from direct regulation to public accounting as a means of government oversight of colleges and universities, and (4) the indirect influence of executive compensation practices in the for-profit sector.

*1. Presidential turnover.* Every few years, the American Council on Education surveys college presidents to determine length of service, age, gender, ethnicity, educational background, and various other variables. This information is disaggregated in several ways (public or private, research universities, baccalaureate institutions, and community colleges). The latest survey conducted in 1995 covered 2,297 presidents in office. For purposes of this study, the salient findings are the following:

• The overall average length of service of presidents is 7.3 years—up from 6.3 years a decade earlier. However, there is a wide variation in length of service according to institutional type. Doctorate-granting institutions show the shortest length of service, ranging from 4.6 years for public and 5.9 years for private institutions—in both cases a drop since 1986. Baccalaureate institution heads average 7.2 years for public and 7.5 years for private institutions—in both cases up from 1986. Public two-year institutions averaged 7.8 years in 1995, a substantial increase from 6.5 years in 1986. The rate of turnover means that many boards—particularly those that govern in public multi-campus systems—are involved in an almost continuous cycle of recruitment, contract negotiation, collection of comparison data, and performance review with their presidents.

• Women lag behind men in length of service for all types of institutions, with an overall average of 5.4 years versus 7.6 years for men. African-American, Asian-American, and Hispanic-Latino presidents serve shorter terms than their white counterparts.

• More than half of presidential spouses are employed, except in doctoral-granting institutions, where only one-third of the presidential spouses are employed. Most spouses work full-time but not in their spouse's institution. Although it still is rare for presidential spouses to be compensated for duties related to the presidency, evidence indicates a growing trend for various forms of spousal remuneration. (Suggestions about how governing boards should approach the issue of spousal duties and remuneration appear in Appendix I.)

*2. Financial management and fund-raising.* Higher education has witnessed dramatic changes in its revenue stream over the past 20 years. Tuition and fees have increased almost five-fold since 1977, more than twice the rate of inflation. Over the same period, the share of revenue from the federal and state governments has declined. Tuition increases have been the steepest in the private sector, although the rates of increase

have been greater in the public sector. Institutions with the resources to do so have increased the amount of financial aid they award to students. This institutional aid is the fastest growing source of grant assistance.

The financial equation for presidents and chancellors is daunting: Reduce costs or manage them more effectively; at the same time, raise more funds from private sources. Private fund-raising has increased exponentially in both public and private higher education, and many public institutions and systems have created foundations to help manage these activities. Many institutions are forming alliances with for-profit organizations to provide such services as distance learning, technological support, and remedial education. As a result, traditional distinctions among public, nonprofit, and for-profit are beginning to fade. Most important, presidents are under pressure to find new ways to generate revenue. Many are being asked to borrow "best practice" management strategies from the business world and to increase revenues from auxiliary efforts to supplement tuition and tax revenues.

*3. Deregulation and accountability.* Many states are moving away from direct regulatory control of colleges and universities. Instead, states and the federal government are holding institutions accountable by asking them to report publicly on a series of performance indicators, some of which are linked to general state policy goals. For public institutions, traditional forms of direct regulation and control—ranging from restrictions on purchasing to program review—are slowly disappearing.

The federal government also has moved in the direction of public assessment and reporting as a means of monitoring (and perhaps controlling) public and independent institutions. Among a plethora of new federal reporting requirements are those relating to campus crime statistics and financial records for financial-aid eligibility and administrative salaries. Particularly relevant to presidential compensation are the

"Form 990" disclosures and new IRS regulations on executive compensation. These are discussed in more detail in the next section.

*4. Corporate compensation.* The booming economy of the 1990s fueled massive changes in corporate compensation practices, as more chief executive officers chose to augment basic salary and bonuses with exercised stock options. Indeed, many corporate boards in the 1980s thought this a good idea, presuming that chief executives would be more productive and effective if they were significant shareholders.

The salary and bonus portion of executive compensation among the top firms declined to just 20 percent of total compensation in 1999, according to *Forbes* magazine. The remainder was composed of a complex assortment of incentive stock options, stock grants, long-term incentive plans (LTIPs), and pay-for-performance options. As a result, in "medium sized" firms with revenues of $250 million to $500 million, total compensation packages average more than $1 million annually. The figure is even higher in the top corporations.

While the facts about compensation for academic presidents are appropriately a world apart, the news media's focus on "excessive compensation" for corporate executives increases the political sensitivities about presidential compensation. In addition, the shift toward incentive and performance-based compensation in the business world has led some colleges and universities to ponder similar arrangements, particularly among institutions that are emulating private-sector management practices.

**Public or Private? Profit or Nonprofit?** The tax laws affecting individual compensation differ greatly between the for-profit and nonprofit sectors, particularly with respect to deferred compensation. In the for-profit sector, there are effectively no limits to the amount of compensation that may be deferred, nor are there limits on the duration over which

deferred payments can be spread. Nonprofit institutions are limited both in the amount they can set aside and in payout provisions after the employment contract has ended.

One of the most common mistakes boards and presidents make in approaching compensation decisions is modeling presidential compensation packages after those from the for-profit sector. This practice can create heavy tax penalties for the president.

Although there are similarities between public and private colleges and universities regarding requirements for presidential compensation, many differences exist as well in the legal and regulatory environment in which they operate. For instance, the IRS intermediate sanctions apply only in the private nonprofit sector. Yet they do cover public presidents if those individuals receive some portion of their compensation from public university foundations. Private institutions likewise are affected by the requirements to file Form 990s, the institutional financial statements that include reports on salaries and benefits for highly compensated employees. Public presidents can defer a portion of their compensation through "qualified governmental excess benefit plans"— an option not available to presidents in the private sector.

Probably the most vivid contrast is that public institutions are accustomed to conducting much of their business in the open, operating under state "sunshine" and open-meeting laws that limit the options for private decision making. These requirements and traditions of disclosure are reflected in the ways that boards approach compensation decisions. Public institutions report much more openness in the process than do private institutions.

# Public Accountability Demands:

## Intermediate Sanctions, Form 990, and Other Forms of Disclosure

The days when a president's compensation was a private matter between the preside nt and board chair are long gone. For better or worse, the current legal and political climate venerates accountability and disclosure. The two most pertinent areas of law are the IRS intermediate sanctions requirements and Form 990 disclosures. Both laws apply only to private nonprofit organizations, but they are germane to the public sector as well. They may even apply directly if presidents of public colleges or universities have their compensation supplemented through foundation or other 501(c)(3) sources. Leaders in both sectors therefore are advised to be familiar with the laws and regulations.

**Intermediate Sanctions: Who, What, When, Why?**
Intermediate sanctions are tax penalties the IRS can levy against the president and members of the governing board if it finds evidence of "excess benefits" in salary and benefit practices. Intermediate sanctions apply to all "disqualified persons" (this is IRS language for key institutional policy makers). "Excess benefits" means pay and benefits that appear too high

for the market, in the judgment of the IRS, or that raise questions about the nonprofit organization's purposes.

The law providing for intermediate sanctions was enacted in 1997 because of congressional and public concern about excessive pay and careless board salary and performance-review procedures in the nonprofit sector. Reports of abuses included salaries set with no performance-review or compensation-comparison information, bonus packages paid from for-profit subsidiaries of nonprofit organizations, and nonexistent or limited board review of compensation packages. Some of the most visible abuses were in the nonprofit arena outside of higher education, but some were in higher education. A few of these became visible because of complaints to the IRS or state regulatory agencies.

Before intermediate sanctions, the only step available to the IRS when it found excessive compensation was to revoke the organization's nonprofit status, an action that officials hesitated to use. As the term "intermediate sanctions" implies, these new penalties give the IRS some enforcement tools that stop short of revoking an organization's tax-exempt status. The law's provisions are retroactive to 1995.

Intermediate sanctions address the policies and procedures for setting and reviewing presidential compensation rather than the actual salary or benefit levels. They do not substitute IRS judgments about what compensation levels or packages for nonprofit executives should be; these decisions remain squarely in the hands of the governing boards. A "high" level of compensation by itself would neither cause an investigation nor lead to sanctions. However, the regulations do mean that *nonprofit institutions must follow certain procedures calculated to result in appropriate compensation decisions and be able to document the procedures they used to set salaries.* Proper procedures, correctly documented, in effect create a presumption that the resultant compensation decisions are reasonable. A party attacking decisions—the IRS, for example—would have to overcome the presumption.

These procedures already are in place in most institutions and should not require fundamental changes in policy or procedure.

If the IRS questions compensation levels, however, and the board is unable to document the bases on which it makes decisions, the board and the highly compensated employees may be subject to the sanctions. The sanctions potentially include payment of back taxes and other penalties. These may be assessed not just against the president but against all board members—in their individual and not their corporate status.

Examples of indicators that might positively influence the IRS in its evaluation of the appropriateness of a board's compensation decisions are (1) evidence that the decisions are made by a delegated subset of board members who have no economic interest in the decision; (2) documentation that the board sets compensation that is generally appropriate for the market, using comparative data from institutions that reasonably would be considered comparable; and (3) evidence that compensation decisions follow a board review of presidential performance.

Intermediate sanctions also cover some kinds of performance-incentive compensation plans in the nonprofit sector, if these incentives are tied to revenue-generating activities. For instance, a president could receive a bonus if the college fundraising goals are met. If performance pay is tied to any revenue-generating activity, IRS regulations require evidence that the revenue benefits the entire organization, supports its tax-exempt purpose, and isn't going to the president or a subsidiary organization that is financially separate from the campus.

Intermediate sanctions are a relatively new area of law, and there is not a long history of IRS enforcement to provide guideposts as to how the law will be interpreted. Future interpretations undoubtedly will lead to refinements in the ways boards approach compensation decisions, particularly with regard to the data for market comparisons and to documenta-

tion of performance review. For instance, national survey data that are not based on customized surveys of true "comparison" institutions may be insufficient to meet the IRS standard for comparison institutions. Boards are likely to be required to justify their comparison institutions on market information that demonstrates why the institutions are valid candidates for comparison purposes. This will be especially important if institutions want to include other nonprofit or even for-profit institutions in their comparison groupings.

The sanctions also could change how boards structure themselves for review and approval of presidential salaries, because all board members—not just those on the pertinent committees—are potentially liable for sanctions in the event of negative IRS findings. In light of these pressures, boards and presidents should determine whether to revise their existing compensation and performance-review practices to ensure that safeguards are in place in the event of a review or audit.

**Public Exposure: "Sunshine" and Form 990.** Public and private colleges and universities operate in the public interest and enjoy the privileges of financial support through direct appropriations and tax-exempt status. The privilege of serving the public interest comes at a cost: Individuals and institutions lose a degree of personal and institutional privacy that accompanies public service. Public institutions must meet accountability demands through "sunshine" laws and political expectations for disclosure. These influence virtually all aspects of board business, because all states require most of the committee and board work to be conducted in open session. While most states allow personnel discussions and a few other matters to be held in executive session, some require these to be conducted in public or to have the results of discussions reported in public session. As a result, the salaries of most public college and university presidents, and sometimes the full details of their compensation packages, are matters of public record.

Although private colleges and universities hold these topics closer to the vest, the Form 990 disclosure requirements are changing this reality. Form 990 is a financial-disclosure statement for nonprofit organizations that is similar to the 10K, 10Q, and proxy information forms filed for the 13,000 companies that register with the Securities and Exchange Commission. Information on Form 990 includes, among other things, the names and salaries of the chief executive and other senior executives, the names of all directors (trustees) and what (if anything) they are paid, whether there are any "self-dealing" transactions (a board member or key employee who sells personal property to the organization), and basic financial information on revenues, net assets, and expenditures.

Since 1991, all private colleges and universities have had to make copies of their Form 990 available to individuals on request. Despite this fact, some institutions have made it difficult for members of the press and other interested parties to obtain the form. And although Form 990s are the primary sources of salary data reported annually in the *Chronicle of Higher Education*, institutions do not report the information consistently. Some report salaries but not all benefits or deferred compensation. As a result, many higher education officials have disparaged the validity and reliability of the information obtained from the Form 990s for comparative or other purposes.

This may be changing. Colleges and universities now must send copies of their three most recent Form 990s to anyone who requests them. If the request is made in person, the forms must be provided on the spot; if the request is in writing (including by fax or e-mail), the forms must go out within 30 days. Detailed provisions affecting photocopying requirements, the amount an institution may charge, and prepayment policies are elaborated in the regulations. The regulations also allow institutions to avoid some of the photocopying regulations if they post the forms on a Web site.

An important change in public access occurred in late in 1999, when interest groups began to post the Form 990s of charitable organizations on the Web (an example is www.guidestar.org). Information on the financial profile of all colleges and universities—including the salaries and benefits of the president and other highly compensated employees—now is on the Web. Or it will be as soon as the roughly five million pages of data from returns of charitable contributions are entered. The data-entry problem is expected to lessen in 2007, when the IRS is scheduled to accept electronically filed reports from charities.

Ultimately, the "guidestar" site will include a database with each of the Form 990 elements. This will allow computerized comparisons of the reports by type, size, and location of the institution. The work is the result of the "Form 990 in 2000" project, which is sponsored by such nonprofit organizations as the Urban Institute's National Center for Charitable Statistics, the National Council of Nonprofit Associations, and Independent Sector. The project is supported through grants from the Ford, Kellogg, and Mellon foundations. The stated goals of the initiative are to increase nonprofits' understanding of and compliance with IRS regulations regarding Form 990 disclosure, improve the quality of information nonprofits report in their Form 990s, and inform the public about Form 990 and the information it contains.

In addition to maintaining the Web site, the project promotes local "nonprofit accountability collaboratives" (NACs) to help educate nonprofits and accountants about how to complete and disclose Form 990s and to recommend ways to improve the quality of reporting. A national "Form 990 Project Office" also exists to help with the efforts of local NACs.

# Board Structure and Decision Making:

## How Boards Can Set and Review Presidential Compensation

The process by which governing boards make decisions about presidential compensation may need to change. Existing processes are not necessarily ad hoc or inappropriately deliberative, but a culture of respect for privacy and circumspection can lead to excessive secrecy. In some cases, important information about board oversight of the president's performance and compensation has been confined to a handful of board members. In the current climate, information about presidential compensation inevitably will become public. This will create problems for any institution or trustee unable to explain and defend compensation practices. It also may place the president in the position of having to explain and defend someone else's decision about his or her compensation.

Among private institutions, presidential compensation reviews and decisions usually are delegated to a compensation or executive committee—and sometimes only to the board chair. The full board rarely is involved directly and may not even be informed of the decision or its basis. Such a practice may leave trustees inadequately prepared to explain why the board decided on certain compensation practices and in the

uncomfortable position of being held responsible for decisions in which they played no part. In worst case scenarios, trustees may be personally financially liable in the event of an unfavorable audit or the imposition of IRS sanctions.

Among public institutions, the full board more often is directly involved in compensation decisions. Regardless of whether board members are involved in discussions, they almost always are informed of the results.

There is no single correct structure for governing boards to use in decisions about presidential compensation. Some boards may believe their existing structure works well and that no changes are needed. Before deciding to maintain the status quo, however, boards and presidents should address the following concerns:

- Boards that delegate compensation decisions to a standing committee must be certain that group has the expertise, institutional memory, and leadership stature to carry out its responsibilities. Because of the technical nature of the topic, some institutions leave compensation decisions to a special committee constituted specifically for this purpose. Other institutions delegate responsibility to the executive committee because the board officers, the chairs of all standing committees, and veteran trustees are members of this group. The executive committee thus can provide a mechanism for internal board communication about compensation decisions. In either event, the board should ensure that a member who might have a personal financial interest in some aspects of the compensation decision remains absent from those discussions and the ultimate decision. For instance, if a president has a performance bonus possibility based on increasing funds from a for-profit subsidiary, an individual who also would benefit from that subsidiary should not be involved in the decision process.

- Boards should establish different decision-making processes for the start of a president's term, the annual performance review, and the three-year or five-year comprehensive review. Different board committees may be appropriate for these different topics. In any event, the board will want to ensure that records are kept to maintain consistency of decisions from prior years.

- Boards that delegate responsibility to a standing or special committee should ensure that all trustees are informed about the employment agreement, compensation arrangements, and the bases for the decisions. This need not be a public discussion, so long as some communication occurs. Boards and presidents may differ on the question of what the full board needs to know because information provided to the full board (especially a large board) is more likely to become public. Occasionally, the president and board chair may have good reasons to keep parts of the discussion confidential. Although individual trustees need not be completely familiar with all aspects of the discussion, they should know how to obtain basic information and where to go for details.

# Public Communication Strategies

The current processes for public communication about presidential compensation are best described as passive and factual. Although boards routinely authorize staff to release to the press a perfunctory statement about the president's salary and accomplishments, these statements rarely contain contextual information about the basis for the decision, the salaries of chief executives of peer institutions, or goals the board has established with the president to guide performance. Public institutions usually are more forthcoming about presidential salary information than private institutions, because the information they release typically concerns only the salary and not the entire package or the context for it. Private institutions typically release Form 990 only on request.

A consequence of the secrecy surrounding the issue is that little objective information exists about presidential salaries and the bases for compensation decisions. This has led to a public perception that institutions and presidents have something to hide. It also has forced presidents to explain or correct misleading or false information. Such situations can create tensions within the college community, particularly with the faculty.

New expectations for accountability should lead to changes in public disclosure practices for presidential compensation.

The goal is to provide accurate information routinely along with other information about institutional accomplishments and priorities. Efforts to suppress or disclose information only on request will create negative perceptions. Boards and presidents might want to rethink their approach to disclosure by asking themselves the following questions:

- Is the completed Form 990 accurate and up to date? Does it include information about total compensation—salary, benefits, and deferred compensation?

- Are all trustees fully informed about the compensation package? Are they prepared to explain and defend the basis for it if necessary?

- Does the institution provide information about compensation on a routine basis, along with other information about the institution? For instance, many institutions are issuing annual public "report cards" to describe their goals and achievements. Information regarding compensation of the president and faculty would be an appropriate component of such a document.

- Can the board take additional steps to ensure that appropriate public officials, the press, or other key stakeholders are informed about compensation decisions? Public communication does not necessarily take the form of a press release. Private, individual communication between board members and key stakeholders—including members of the legislature—can be an effective way to ensure openness while maintaining some degree of circumspection.

**A Successful Public Information Strategy.** Some public institutions have approached the issue of public communication and executive compensation in interesting ways. In California, following legislative concern about "excessive executive compensation" in the early 1990s, the state higher education coordinating agency was required to prepare an annual

report on executive compensation in the three public systems. The Board of Trustees of the California State University decided to use the situation as an opportunity to improve public understanding of presidential compensation. The trustees conducted a study of presidential compensation in the same institutions that were used by the state for faculty salary purposes. Because public information about total compensation was not readily available, the board hired a consultant to help with the research. The results of the study showed that presidential compensation on average lagged considerably behind their comparison institutions.

To ensure that the institution was able to recruit and retain good leaders, the trustees set a goal of closing the gap and reaching parity with comparison institutions. Individual board members met with legislative officials to explain the study, document the basis for the board's position, and win state support. As a result, presidential compensation has increased, and a hot-button topic has received little public attention.

# Information and Expertise

In making decisions about presidential compensation, boards rely heavily on outside information and expertise. Typically, boards seek information about compensation from peer institutions, and they ask professionals who specialize in executive compensation to help develop presidential contracts and facilitate information gathering as it relates to compensation.

**Comparison Data.** Creating compensation benchmarks has long been a common practice in higher education, and all institutions that participated in this project's survey reported using some kinds of comparison data in their salary-setting process. More than half of the public institutions and nearly two-thirds of the private ones said they used national data. In addition, half of the institutions in both sectors reported that they supplemented national data with their own surveys. Chief executives and board chairs said good comparison and market information was the single most important piece of information they needed to improve compensation decisions. Although individuals in both sectors said they were "generally satisfied" with the information they obtained, they also indicated a high degree of frustration in receiving accurate and timely data.

National survey data are unlikely to provide good comparison information for decisions about presidential compensation.

For one thing, the intermediate-sanctions regulations strongly suggest that the compensation process must focus on peer institutions. Because national surveys are voluntary, many institutions do not participate. Further, national surveys underreport information about personal benefits, deferred compensation, and salary supplements from foundation sources. The result is a distorted picture that probably understates total compensation and may perpetuate fairly conservative benefit packages.

Boards are likely to need customized surveys to obtain comprehensive information about compensation arrangements and to demonstrate they have fairly reviewed market comparability. One incentive for other institutions to participate in private surveys is the assurance that they will receive a summary of the results.

The private surveys may be conducted by experts (including compensation consultants, accountants, or attorneys) or in-house staff, although in either case the president or the board chair should request this information on a confidential basis. Professionals who do this type of work are more likely to know what questions to ask and to be aware of market trends. Regardless of who does the survey, the president should not supervise the information collection because of the potential for perceptions of self-interest.

**Use of Experts.** In addition to finding professional help for the comparison surveys, boards increasingly are turning to outside experts to help develop the compensation package, conduct salary negotiations, formulate contracts, and facilitate performance reviews. Though the use of consultants remains relatively rare—less than 20 percent of institutions in the survey said they used consultants—many presidents and board chairs suggested that "securing professional help" was the best advice they would give to others beginning the process.

Clearly, few people know where to go for neutral, credible advice. Presidents may hesitate to seek private counsel, fearing

the board will take this as a signal that the president is unhappy or is trying to leverage something in the contract. As a result, many boards rely on in-house staff or allow the president and the board chair together to guide the process. This can lead to mistakes borne of ignorance of legal or other requirements because these individuals may not be up to date about tax or public-disclosure requirements. Sometimes, unnecessary internal tensions may develop if individuals who eventually will report to the president become privy to details of a compensation package while it is being negotiated.

Hiring an outside professional probably is most important when the board has hired a new president and is negotiating his or her first employment contract. Executive search firms sometimes can provide this expertise, but if the board expects outside help in contract negotiations, it should state this in the RFP for the search contract. Before allowing a search firm to help with contract negotiations, the board should be confident that the search firm is qualified. Other criteria that might factor into a decision about using outside help include the following: (1) a need for special expertise in technical areas of nonprofit and tax law; (2) internal reporting relationships that make involvement of in-house staff inappropriate; and (3) a need for an independent presence to ensure that stakeholders trust and support the process and results (for instance, to ensure credibility of comparison surveys).

Elements in the executive compensation process where outside expertise becomes advisable include (1) creating benchmarks for salary and compensation, (2) setting initial compensation, (3) developing and negotiating the contract, and (4) facilitating the periodic comprehensive performance review.

# The Contract:
## Minimums and Maximums

There is a surprising degree of informality surrounding the terms of employment agreements between many boards and presidents. Almost half of the institutions in both sectors report that they have no compensation or employment contracts, although many more have loosely structured "letters of agreement" that serve similar purposes. The absence of detail in the contracts may be attributable partly to the dearth of available information about what can and should go into a presidential contract, because most public information reports only salaries and some benefits. Although no laws require contracts between boards and chief executives, the reality of the current higher education marketplace suggests that contracts to codify basic agreements between boards and presidents are increasingly expected and accepted.

Interviews with board members and presidents suggest that some may shy away from contracts because they do not want attention to the details of a written agreement to interfere with informal communication. A contract never should stand in the way of regular discussion between a board and president. But it can be a helpful tool at the time of the initial hire to ensure clarity and mutual understanding between a board and the chief executive about basic compensation, powers and duties, benefits, performance reviews, salary adjustments, and provi-

sions for separation, including retirement, voluntary resignation, or termination by board action.

The chief executive's first employment contract is especially important, because it sets the base for future adjustments and defines the expectations and process for review. However, the press of the search process and the incoming president's lack of familiarity with the institution may mean that a comprehensive contract is not practical when a president is hired. If this is the case, the board and the president can commit to a comprehensive review of the contract early in the first year of the presidency. This review does not have to be tied to a performance review and need not address the base salary if this is not an issue. Such a review does give both parties an opportunity to discuss additional aspects of the employment relationship that may not be clear at the time of the initial hire, including many of the "other terms and conditions" of employment that are discussed in Appendix I.

The components of compensation will change, depending on individual circumstances such as the president's age and family circumstances. In particular, the tax consequences related to different forms of compensation should be considered for each individual. Chief executives should know what questions to ask to be fully informed about their options. Appendix I describes the types of arrangements that boards and presidents might incorporate into an employment contract.

**Minimums and Maximums: What Should Go Into a Contract.** Employment agreements or contracts vary widely among institutions. They may be short statements that outline basic terms or more elaborate and formal documents that detail agreements about all aspects of the employment relationship. The contract is best confined to terms and conditions of presidential employment and should not extend to institutional plans and policy matters, though these can be referred to in the context of the presidential performance review.

A "bare bones" contract should include as least the following: the term of the appointment, compensation and benefits (direct and indirect), and the processes for evaluation, review, and termination. It can include much more, including the kinds of provisions detailed in Appendix I.

*1. Term of appointment.* The contract should specify the term of the presidential appointment and include provisions for compensation if either the president or the board terminates employment before the end of the contract period. Contracts typically extend for three to five years, although some are year to year, and some are open-ended (although these frequently include termination and review procedures). One innovation is a so-called "evergreen" contract, which runs for a specified duration (usually one or two years) and automatically renews for another contract period after each successful performance review. Employment agreements often provide that if the board chooses to terminate the contract before the end of the contract period without cause, it must pay the remaining compensation due the president. If the president elects to terminate the contract, he or she forfeits the remaining pay.

*2. Compensation package.* Salary, benefits, retirement, and deferred compensation are basic elements of the compensation package. Various perquisites also can be included. The contract should describe all elements of the total compensation package.

Federal law now limits the flexibility boards have to augment presidential compensation through enhanced benefits or retirement packages. For example, nondiscrimination rules applicable to "tax qualified" retirement arrangements generally prohibit giving the president benefits or retirement packages that are greater than those paid to other employees. In addition, several years ago Congress modified the Internal Revenue Code to

limit retirement benefits and pretax contributions to pension plans in the nonprofit sector. While the specific limits vary depending on the type of tax-qualified plan and on the hiring date of the individual, these new limits mean that employees hired after January 1, 1990 may not receive employer-paid retirement benefits from a defined benefit retirement program greater than $135,000 per year (or 100 percent of the final salary, if less). This limit applies even if the president already has earned benefits based on age and contributions that would justify higher payments. Similarly, the amount of compensation that may be taken into account under an institution's tax-qualified plan is capped at $170,000 in 2000.

Congress again amended the law to allow creation of what are known as "qualified governmental excess-benefit arrangements." These plans allow employees of state and local entities to receive retirement benefits above the $135,000 limit mentioned above. At this writing, the "excess benefit" arrangements are available only to employees in public institutions, although several recent omnibus tax bills have included provisions to extend them to private nonprofit institutions. The likelihood that such an option will be extended in the future increases the importance of knowing what the current tax law allows in assembling compensation packages. Simply put: Presidents and boards must understand any limits to retirement benefits for individuals in their sector of higher education. More information about "excess benefit" arrangements is provided in the section describing different forms of deferred compensation.

*3. Evaluation and Review.* The basic contract should outline the expectations for salary adjustments and performance reviews. No adjustments to salary should occur without some form of performance review, nor should salary adjustment be the primary reason for performance evaluations.

The AGB book *Presidential and Board Assessment,* by Richard T. Ingram and William H. Weary, suggests that boards conduct annual presidential performance reviews and a self-review every three to four years. In addition, it suggests more thorough and comprehensive concurrent reviews of board and presidential performance every five to ten years, when the incumbent chief executive has served for at least five years and is likely to remain on the job for an extended period. Although the contract need not contain details about goals and expectations for performance reviews (these should be discussed outside of the contract), it is important for the contract to codify the general nature of the review process and the approximate timing of all performance evaluations.

*4. Termination.* Inadequate attention to arrangements for the end of a presidency and for employment termination can place chief executives and boards in uncomfortable situations that can harm the institution. Provisions to terminate the contract should be part of the basic employment agreement. These should include advance-notice requirements and subsequent compensation expectations for both parties. Chief executives leave for various reasons, and post-employment compensation will vary depending on those circumstances: One party or the other may be unhappy, justifiably or not; or the president may want to retire, assume another presidency, or return to teaching and scholarship.

In addition to describing the general terms of the separation agreement, the contract should clearly specify the circumstances under which different kinds of compensation may be provided. For example, the institution may offer a faculty position but only in instances of voluntary separation. For chief executives who plan to retire, some institutions provide a one-year transition plan that includes travel and living expenses for sabbaticals or research opportunities on another campus.

Earned sabbaticals are an alternative to deferred-compensation plans, which allow payments to be dispersed after the individual leaves the presidency. Although sabbaticals are not technically a form of deferred compensation, they provide compensation for a period when the president is not present and performing normal administrative duties.

**Deferred Compensation.** Because federal law limits retirement benefits and pretax contributions to retirement, deferred compensation has become a common way for boards to enhance presidential compensation packages. The types of deferred-compensation arrangements available in the public and nonprofit sectors are much more limited than in the for-profit sector. For this reason—and because the tax laws are changing rapidly in these areas—chief executives and boards considering forms of deferred compensation should consult private counsel to identify the best arrangement. The basic types of deferred compensation now available include the following:

*1. Qualified governmental excess benefit arrangements.* These plans, available in public institutions, operate as part of a tax-qualified defined benefit retirement plan. Under an excess benefit arrangement, the plan must use the appropriate compensation limits for the employees—either the general $160,000 or the grandfathered amount for employees hired before January 1996.

*2. Section 457 Deferred Compensation.* Deferred-compensation plans are agreements between an employer and an employee that provide for future payments for services currently rendered. Section 457 of the Internal Revenue Code governs these arrangements, which may be established only by public or nonprofit employers. Contributions may take two forms: "eligible" plans, which are subject to an annual contribution limit of $8,000, and "ineligible" plans, for which there are no limits on contributions. In the case of an eligible 457 plan, the $8,000 limit

is reduced by any contributions on behalf of an employee to a 403(b) tax-sheltered annuity or custodial account. Thus, for employers who are permitted to have 403(b) arrangements, eligible 457 plans are not very useful.

To avoid including contributions to "ineligible" plans in the chief executive's current taxable income, the benefits must be subject to a "substantial risk of forfeiture." In general, this means there must be a substantial future service requirement that the chief executive will not necessarily meet as a condition of receiving the benefits—a minimum term of service in the presidency, certain performance goals, or both. The assets in these arrangements generally must be owned by the employer and subject to the claims of the employer's creditors. However, they may be set aside through institutionally owned annuity contracts or held under trust arrangements, which are known colloquially as "rabbi trusts." (The term evidently arose because the first person for whom one was established was a rabbi who wished to defer compensation but did not want these resources to be under the direct managerial control of the congregation.) Compensation deferred through a combination ineligible 457 plan/rabbi trust will be fully taxable in the first year it is not subject to a substantial forfeiture. Because these rules are complex, professional advice is essential.

*3. Section 403(b) Tax-Sheltered Annuities (TSA).* A TSA plan allows a president to defer paying taxes on premiums paid to an annuity contract or invested in mutual fund shares through a custodial account held by a bank custodian. TSAs are available only to public schools or colleges and universities, organizations exempt from tax under 501(c)(3)—which exempts most private colleges and universities—and certain types of ministries. TSAs generally are fully vested and have no risk of forfeiture, and surviving spouses may be entitled to the benefits in the event of the partner's death.

*4. Other Arrangements.* Other more sophisticated arrangements may be employed to provide elements of tax deferral. These arrangements include bonus life insurance plans, split-dollar insurance plans, and salary-continuation plans. Under a bonus life insurance plan, the college or university pays a bonus to a president to allow him or her to purchase life insurance coverage. A split-dollar life insurance plan is similar, except the institution retains a degree of control over the policy. In these arrangements, the institution often takes out and owns the policy, and premiums are paid both by the president and the institution; the portion of the premium paid by the president is nontaxable. Salary-continuation plans can use life insurance to finance a deferred-compensation plan.

A TSA can be used as the institution's primary retirement plan for faculty and staff (including the president), or as a voluntary savings arrangement, or both. Under a voluntary savings arrangement, tax-deferred contributions by the president generally are limited to the lesser of 20 percent of compensation or $10,500 (for 2000).

*5. Severance Pay.* Severance-pay provisions allow a president and board to agree on a lump-sum payment at termination of the presidency. Severance pay is common when a board chooses to end the contract without showing cause before the end of the contract's term. The contract provisions regarding termination procedures should include the terms under which severance is to be paid. The difference between a severance-pay package and other ways of deferring compensation is that severance pay usually is made in a lump sum or a limited number of installments, and taxes are paid on it in that tax year.

*6. Sabbatical Leave.* Another way to provide income past the end of the president's term of active service is to pro-

vide for a paid sabbatical leave upon termination from the presidency. This allows the outgoing chief executive to receive a salary and benefits over a transitional period in his or her life. Such sabbatical arrangements also may include provisions for housing and travel.

In addition to providing compensation for an agreed-upon period following the end of the president's active service, these arrangements have the benefit of smoothing the transition for the president away from the life-consuming responsibilities of the job. If structured to do so, they also can ensure that the president is away from the campus. Sabbatical leave expectations should specify the length of the leave, as well as the kinds of duties the president should be expected to perform, such as research and writing or community service. Public institutions especially must delineate these expectations, and the president must fulfill them, so that no one will raise questions about gifts of public funds.

# Conclusion

Boards should understand that although the phrase "chief executive officer" often is used interchangeably between the corporate world and higher education, there are similarities and differences when comparing the two. In both worlds, chief executives share the desire to maximize the organization's success; in this regard, they are both accountable for the "bottom line." Although colleges and universities must be operated in a "businesslike manner," they differ from businesses, and "success" is defined differently. Thus, the roles of college and university presidents differ from those of their corporate counterparts in several respects:

- Their responsibilities far exceed their authority because of statutes, bylaws, or institutional culture. Faculty, alumni, students, legislators, governors, and others frequently claim authority accorded chief executives. What's more, college and university presidents frequently supervise individuals—big-time athletics coaches, medical school experts, top-flight researchers—who have special constituencies and salaries far higher than the president's.

- Particularly in the case of public institutions, presidents are subject to a host of legislative and regulatory mandates that inhibit their flexibility and erode their authority.

- Because most colleges and universities are nonprofit, their "bottom line" is more elusive than in the commercial world, which focuses on stock prices, net revenues, or comparable quantitative measures. Fundamentally, college and university presidents are motivated to attract funding to invest in the enrichment of the institution's mission, while for-profit chief executives must build value for shareholders.

- College and university presidents generally reach such positions after having served successfully as teachers and scholars. In most cases, they also have gained some academic administrative experience. Much of their work as teachers and scholars does not truly prepare them for the responsibilities of the presidency, but it remains unusual for a person to become a president without such a background. While most corporate chief executives rise to the top within a single organization that pays close attention to succession planning, the prevailing pattern in higher education is that presidents are appointed from outside the institution.

The job of the college or university president requires a wide range of skills to deal with the myriad of conflicting responsibilities and constituencies. Increasingly, presidents are required to be fund-raisers; indeed, this is the foremost responsibility of presidents of private institutions and a growing part of the job of public institution presidents. They also are expected to be visionaries and planners for the future of their institutions. They must be effective in working with such external stakeholders as alumni, major donors, students, elected leaders, and others. They are expected to lead the faculty while being respectful of the faculty's prerogatives and governance structure. They need to be visible and comfortable with students. They must be intimately familiar with and decisive about the financial realities of the institution. They are constantly on call, and for much of the year they have very few free evenings or weekends.

The academic presidency is a position that calls for the patience of Job, the diplomacy of Solomon, and the stomach of a goat. This book offers policies and procedures that boards should consider in establishing, reviewing, and disclosing presidential compensation. It emphasizes that the modern-day college and university president requires consideration on a wide array of matters beyond salary. It is our hope that the advice in this book will help boards find, reward, and sustain effective leaders. Superb presidential leadership never should be taken for granted.

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APPENDIX I

# Additional Options to Consider in Compensation Contracts

president's employment agreement may include many optional compensation provisions. Not all of these provisions are appropriate for all presidents or institutions, nor do the details about these provisions necessarily need to be part of an employment contract. However, if they are part of the agreement, both parties should discuss and understand them.

*1. Salary bonuses.* The survey of chief executives and board chairs suggests that salary bonuses (which include pay-for-performance agreements and "longevity bonuses") remain relatively rare in higher education. Less than 10 percent of institutions reported such arrangements. Yet they are a topic of interest and are likely to become more common in the future. Some believe bonuses for college and university presidents are inappropriate or politically unseemly and argue against bonus arrangements on that basis. Others believe they offer appropriate incentives for the achievement of goals. A benefit of a bonus system is that it requires the board and president to discuss goals and quantifiable performance measures. In institutions that have faculty pay-for-performance

programs or post-tenure reviews, publicly linking a portion of the president's pay to performance can be politically helpful.

Bonuses are distinct from other kinds of salary raises because the amount of the bonus does not go into the salary "base" for subsequent years. Bonuses are based either on length of service or on such mutually agreed-upon performance goals as enrollment or private fund-raising. Bonus payments are always taxable income, of course, unless they come in a form that qualifies for an exclusion from income.

*2. Housing.* Most institutions provide the president with either a house or a housing allowance. If living in the house is a condition of employment for the president—either as a convenience to or requirement of the institution—then the value of the housing or the allowance typically is not considered a taxable benefit. The employment agreement therefore should include a written provision that states the president is required to live in the house.

Many agreements also specify that if the IRS determines that compensation related to housing should be reported as taxable income, the institution will increase the salary (or "top up" the salary) by the amount necessary to pay the additional tax.

Issues sometimes arise on taxability of housing benefits if the house is not located on the campus. To address this eventuality, the institution should maintain records that document that the house is used for business purposes in a significant and continuous fashion. Some presidents want to maintain their own private residence during the course of the presidency, even if they are required to live in a university-owned house. In such cases, the interest costs of a private house are tax deductible.

*3. Spousal recognition and compensation.* The "two for the price of one" presumption, where the president's spouse is expected to be an unpaid employee, is eroding. Increasingly, presidents are part of a dual wage-earning team in which the spouse has a professional life. But a spouse need not be employed outside the home to decline to be an unpaid volunteer to the institution. Boards should not be presumptuous in this regard. Spouses who are "expected" to perform social or other responsibilities should be interviewed along with the president, and the expectations must be fully discussed.

If the president has no spouse, or if the spouse chooses not to assume the social responsibilities of the presidency, the board and president should clarify their expectations about staff support for entertaining. Also, if the board prefers that the spouse *not* be directly involved in university business, or if it prefers the spouse to be employed only in work that is separate from the president's day-to-day offices, this should be discussed and mutually understood as well. If the spouse chooses to take on responsibilities that ordinarily would require staff to be hired, appropriate compensation is fully justified.

Spouses who do not take on compensated employment still may perform significant social roles for the institution. In these instances, purchasing a separate annuity in the spouse's name is an increasingly popular and appropriate way for a board to express the institution's recognition and appreciation. The board also can recognize the spouse as an employee for purposes of business travel, so that he or she can be covered by university insurance. This can be particularly important when the spouse drives the university car with the president as a passenger.

*4. Supplements from public institution foundations.* Many public colleges and universities with affiliated founda-

tions report that they use foundation resources to supplement presidential compensation. While salary supplements from foundation sources may be legitimate, the board should not use them to avoid public disclosure of compensation. Foundations that want or need to play a role in supporting the president should consider other ways to support the *presidency* if public funds cannot be used for these purposes. For instance, it is appropriate to use foundation resources to help with some of the social aspects of the presidency, especially for events that involve private fund-raising. These can include entertainment expenses, spousal travel, and club memberships.

*5. Limits on outside employment.* The board and president should discuss whether the president expects to derive income from outside employment. Many presidents want to continue their consulting or scholarly work. The board and president should agree at least in general terms about what boundaries, if any, should be set.

*6. Automobile.* Many institutions provide the president with a car for business and personal use. Presidents permitted to use the car for personal purposes should maintain records about usage patterns for income-tax purposes. If the institution maintains the automobile insurance policy, provisions should allow members of the president's family to drive the car and be covered under the policy.

*7. Business travel, including spousal travel.* Most institutions reimburse the president for all business travel. If first-class travel is permitted, this should be made explicit. The agreement also should clarify policies concerning spousal travel.

*8. Entertainment expenses.* The agreement should clarify expectations for reimbursement of entertainment

expenses. These may include the costs of mailing invitations, decorating, bartending, staff support, and preparation. The agreement also should stipulate whether the president has a fixed allowance or is to be reimbursed for all out-of-pocket expenses. Other issues to consider include the size of the budget, whether university facilities are available for entertainment purposes, whether the president is obliged to use the university catering business, and who is responsible for organizing and cleaning up after these functions.

*9. Club memberships.* Many institutions provide presidents with memberships in athletic, country, or social clubs and pay the dues on behalf of the institution. The IRS may not view the value of dues as deductible from income if such memberships are not used exclusively for business purposes. Institutions that want the president to participate in clubs might consider "topping off" provisions to increase salaries if club dues are counted as taxable income.

*10. Personal use of university recreational, vacation, or retreat facilities.* Free or discounted use of university recreational, vacation, or retreat facilities may be counted as taxable income under some circumstances. If family members are entitled to the use of these facilities, this must be clarified.

*11. Dependent tuition assistance.* Provisions for tuition assistance for dependents of the president should specify the duration of this benefit and note any limits on the types of institutions dependents are eligible to attend. For instance, many institutions participate in "tuition exchanges" to allow the president's family members to receive tuition assistance from other institutions involved in an exchange.

*12. Academic rank or tenure status.* If the president wishes or is expected to hold a faculty appointment, there should be a discussion about how the rank or tenure status is to be determined. If the board offers a faculty position as a "retreat" position at the end of the presidency, it must specify the basis of this arrangement.

*13. Moving expense on entering and leaving the presidency.* The agreement should specify whether moving expenses are to be paid for the president and his or her family, both entering into and leaving the presidency.

*14. Child care.* The agreement should specify whether a child-care allowance or reimbursement for child care is to be provided and whether university facilities are available.

*15. Outside financial or legal counsel.* The agreement should specify the circumstances under which the board will pay for the cost of hiring outside financial or legal counsel for the president.

## APPENDIX II

# Summary of Survey Results

survey asked board chairs and presidents from a sample of four-year and two-year public and private institutions about policies and procedures for setting and reviewing presidential compensation. The survey requested information on board structures for setting and reviewing compensation, sources of information and expertise on compensation, strategies for communicating about compensation, components of a compensation contract, and perceptions about the overall adequacy of the process.

Despite repeated follow-up, the final response rate was not as high as had been hoped, although it was higher among presidents than among board chairs and higher in the private sector than on the public side. In the public sector, 38 percent of the presidents and 22 percent of board chairs returned surveys; on the private side, the respective figures were 51 percent and 32 percent. The rate of return does not allow definitive judgments to be reached about some issues and is not adequate to identify major differences between two-year and four-year institutions or research institutions and comprehensive colleges. The survey nonetheless illuminates some general issues related to how boards approach compensation decisions. For instance:

- The large majority of presidents and board chairs in both

public and private institutions say they are "reasonably satisfied" with the compensation decision process and with compensation levels. The majority also think presidents are fairly compensated, although there is more dissatisfaction with compensation levels in the public sector. No one thinks presidents are overcompensated.

- Most reported compensation packages were "plain vanilla" combinations of salary, benefits, and retirement. Relatively few respondents report using bonus or deferred-compensation arrangements. Less than 10 percent in either sector now report having bonus or incentive salary arrangements. Those that have bonuses base them on such things as length of service, enrollment increases, or other mutually agreed-upon goals.

- Respondents in both sectors say their internal board procedures for setting and reviewing compensation are well understood. They delegate most discussions to committees and use both national and customized comparison surveys to benchmark compensation information. The full board is much more likely to be either directly involved in this process, or informed about it, in the public sector than in the private sector. For instance:

  - A committee of the board conducts the annual review in 52 percent of public and 70 percent of private institutions, by the full board in 23 percent of publics and 13 percent of privates, and by the chair and the president alone in 20 percent of both publics and privates.

  - The full board must review and approve the compensation package in almost all public institutions, but this is the case in only about one-third of private institutions. Nearly two-thirds of private institutions leave these matters to a subcommittee or to the board chair. The full board is not even subsequently informed of the results of these decisions in nearly one-third of private institutions.

• Most board members are "not very" knowledgeable about the president's base salary, according to 51 percent of private board chairs. This figure rises to 58 percent of board chairs who are "not very knowledgeable" concerning awareness of benefits and perquisites. Public-sector board chairs respond quite differently to these questions: 93 percent say the board is "very knowledgeable" about salary, and 80 percent say it is "very knowledgeable" about perquisites and benefits.

• Public institutions more often publicly disclose compensation levels than do privates. Forty percent of public institutions provide public statements about the complete compensation package, and another 12 percent provide information only on salary and benefits. Among private institutions, 86 percent do not provide public statements about compensation but respond to requests for Form 990.

• Some form of performance review is required for salary adjustments in 75 percent of public and 80 percent of private institutions. Those having performance reviews report that the process works well; respondents had no particular complaints or advice about how to improve this process. The majority of presidents think their performance-evaluation system works well and that no major changes are needed.

• Most institutions do not use consultants to help with any aspect of the compensation process—from initial hiring, to contract negotiations, tax advice, or performance review—and don't seem to think they need to. Less than 20 percent in each sector use consultants.

• Presidents and board chairs report using a combination of national data and their own surveys for information about salary comparisons. Presidents in 54 percent of public and 69 percent of private institutions rely on national data, and a majority in both sectors report collecting some form of supplemental data for compensation adjustments on an annual

basis. Board chairs are not generally familiar with how the comparison data are collected.

• A significant number of institutions—40 percent of public and 48 percent of private—have no formal employment contract between the board and the president. In those institutions with contracts, the contracts do not always specify details about all aspects of compensation, benefits, and perquisites. Nearly 43 percent of public and 44 percent of private institutions have no provisions for termination in the contracts, other than notice requirements.

• Board chairs of private institutions are more familiar with IRS regulations than those in the public sector. Fifty-two percent of private institution chairs say they are "generally familiar" with the intermediate-sanctions regulations (21 percent say they are familiar "in detail"), in contrast with 47 percent in the public sector. Forty-seven percent of public and 27 percent of private institution chairs say they are "not familiar" with them.

• Large majorities of boards in both sectors (nearly 90 percent in both sectors) set no limits on the ability of presidents to sit on outside boards, including boards that provide stipends to the president.

• Only 10 percent of public institutions supplement presidential compensation packages through resources from private foundations affiliated with the college. Among those that do so, presidents and board chairs say they believe foundation supplements are appropriate and necessary to ensure competitive packages.

• Perceptions of constraints that limit capacity to set compensation at desirable levels are, in rank order, resources, data, process, communication, public perceptions, and politics. Salary caps in the public sector are rare, although perceived political constraints in setting salaries are common. Most in

the public sector say that public disclosure of compensation information poses no constraints.

- When asked what advice they would give others, presidents say: "Get the best data, know the market, and know your options," "Be open and frank in the process," and "Get someone to help understand your options with benefits and with negotiations." Board chairs say: "Know your competition and the market," "Be clear with your candidates or the incumbent president about the process you want to follow," and "Use outsiders to help with the contract."

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